EXTENT OF USE OF PERFORMANCE BASED PAY IN COMMERCIAL BANKS IN KENYA

NZIOKA JOYCE

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DECLARATION

This is my original work and has never been submitted for a degree in any other University.

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This project has been submitted with my approval as the University Supervisor.

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DEDICATION

This research proposal is sincerely dedicated to my husband Mr. Joshua Nyamweya, Who gave me unwavering support and encouragement through out the course.

To my children Eugene and Abigail who bore the brunt of an absentee mother during the course. May this work greatly inspire them.

To my entire family whose love and support have been immense and humbling.

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To my best friend Lucy who gave me undivided attention as I struggled to complete my studies.

ABSTRACT

Performance based pay among commercial banks is relatively new and most of the banks have been advised to use it to reward high achievers.

The purpose of this study is to investigate the extent of use of performance based pay in commercial banks in Kenya. Existing literature shows that once implemented performance based pay helps to foster team work and contribute to overall improvement in productivity of staff.

The research design used in this study was a descriptive research design and the population consisted of 44 commercial banks. The respondents will be the Human resource managers in the banks. The data collection method used was a structured Questionnaire that was divided into three parts. The data was analyzed using tables.

The findings from the study showed that 50% of the banks started using the performance based pay after reorganizations in their systems and structures. All the commercial banks use one form of performance based pay or another and whereas multinationals have standards set from their head office, the local banks decide which form of performance based pay suits their operations.

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CHAPTER ONE: INTRODUCTION

1.1 Background

1.1.1 Compensation

Compensation is a systematic approach to providing monetary and/or non-monetary value to employees in exchange for work performed (Murphy, 1998). Compensation may achieve several purposes assisting in recruitment, job performance, and job satisfaction (Stebler et al, 1997).

Compensation is a tool used by management for a variety of purposes to further the success of the company. Compensation may be adjusted according the business needs, goals, and available resources (Stebler et al, 1997). Compensation may be used to recruit and retain qualified employees, increase or maintain morale/satisfaction, reward and encourage peak performance, achieve internal and external equity, reduce turnover and encourage company loyalty, and modify (through negotiations) practices of unions (Houston and James, 1995). While an employer may set compensation levels for new hires and advertise those salary ranges, it does so in the context of other employers seeking to hire from the same applicant pool (Conyon and Schwalbach, 1997). Therefore, a good pay package, among other motivational pacts increases employee performance.

1.1.2 Performance Based Pay

Performance-based pay, in which compensation is linked to employee performance, is one form of organizational pay structure, as it motivates employees to devote effort to their individual performance by controlling their behaviours and outputs (Oliver and Anderson, 1995). Performance-based pay serves to enhance effort and upgrade workforce quality (Landau and Leventhal, 1976) motivating effort, and attracting talent when effort and talent are not easily observed (Holstrom, 1979; Levintal, 1988). Jobs with performance-related pay attract workers of higher ability and induce workers to provide greater effort (Booth and Frank, 1999). Thus, according to agency theory, the design of a compensation scheme is be guided by a trade-off between risk and incentives (Sloof and Praag, 2005).

Performance based pay links compensation to a measure of individual, group or organizational performance (Murphy, 1998). There has been substantial growth in the use of performance based pay systems worldwide over the past years. While the original performance related pay systems were concentrated in the private sector, an increasing number of public sector employers have introduced schemes recently, or are considering doing so (Zingales, 2000). The introduction of performance related pay in tandem with other work practices to enhance employer commitment and performance further complicates the situation. It makes it extremely difficult to disentangle the association of performance related pay per se with performance and those of the practices with which they are typically jointly introduced. This is made more difficult because there are possibly strong interactions between such employee involvement schemes and performance related pay (Hall and Liebman, 1998).

Many performance-related pays tie pay to work-group or firm performance measures. Some are based on "soft", subjective measures of output, such as merit pay (Hauston and James, 1995). There are also schemes that link a component of pay to the profits of the employing organization or offer employees' shares in lieu of cash as forms of group performance related pay scheme. These can also be regarded as akin to performance related pays, albeit involving a very indirect link between performance and pay. In short, studies which focus on individual measures of performance related pay (and especially those simply concerned with piece-rates) are ignoring a wide range of schemes that explicitly tie pay to a measure of performance and that these may differ in their relationships to organizational performance.

Pay systems for non-executive staff have generally been characterized by standardization across and within sectors (e.g., government, particular industries) and within enterprises (Hall and Liebman, 1998). Indeed, standardization, while being equitable from the point of view of employees, benefit employers as well by reducing competition based on labour costs.

With the gradual opening up of economies to world trade and foreign investment, local employers are now compelled to compete with enterprises with sophisticated technology, more productive ways of providing goods and services, and the advantage of being global players (Hubbard and Palia, 1995). In many instances these foreign enterprises are able to attract the best local talent on terms and conditions beyond the capacity of many local enterprises to pay. With the acceleration of the process of globalization, accompanied by the movement of former centrally planned economies towards market economies, governments and private enterprises have had to compete in the global market by developing competitive advantages, which are affected by costs and quality.

These developments have several implications for pay systems. Employers (and some governments) see that pay increases need to be more than matched by productivity increases if competitiveness is to be achieved or maintained. The relationship between pay, productivity, skills and inflation was understood quite early in Asia by Japan as well as the newly industrialized economies (Crawford et al., 1995).

In these circumstances a major concern for employers will be to negotiate pay systems which: achieve a strategic business objective; are flexible in that their variable component could absorb downturns in business and reduce labour costs; are oriented towards better performance in terms of productivity, quality, profit, etc; are capable of enhancing workers' earnings through improved performance; are capable of reducing the incidence of redundancies in times of recession or poor enterprise performance through the flexible component of pay; are able to reward good performance without increasing labour costs, and are able to attract competent staff (Zingales, 2000).

1.2 Commercial Banks in Kenya

Commercial Banks in Kenya are governed by: the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). The banking sector was liberalised in 1995 and exchange controls lifted. The CBK, which falls under the Minister for Finance's docket, is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya's commercial banks and non-banking financial institutions, interest rates and other publications and guidelines. The banks have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks' interests and also addresses issues affecting its members.

Currently, there are forty-four commercial banks in Kenya (CBK, 2007). Thirty-five of the banks, most of which are small to medium sized, are locally-owned. The industry is dominated by a few large banks most of which are foreign-owned, though some are partially locally-owned. Six of the major banks are listed on the Nairobi Stock Exchange. The commercial banks offer corporate and retail banking services but a small number, mainly comprising the larger banks, offer other services including investment banking. They are faced with a lot of challenges that requires only those with the best mix of personnel and objectives to survive. Such challenge is competition. The increasing competition amongst commercial banks in Kenya has forced the management to use various tools they deem best to manage their employee performance. The choice of method to use to manage employee performance is the challenge that most of the commercial banks face (Morgan, 1998).

The commercial banks continue to be radically transformed by applications of new technology in Kenya. The evolution of the banking industry has presented both challenges and opportunities for commercial banking institutions. Over the last several years, financial modernization, deregulation, industry consolidation, the rise of new institutions, shifting trends in borrowing and lending, globalization and emerging technology have influenced and affected how commercial banks operate.

1.3 Statement of the problem

Performance based pay has been largely used by banks to compensate the executives (Houston and James, 1995; Hubbard and Palia 1995; and Crawford et al. 1995). Compensation structure is important, especially when business management is perceived as a multi-person team task rather than a single man's (CEO) show. Zingales (2000) advocates the multi-person team view, pointing out that the new (and future) "dot.com" companies depend critically on the quality and "bond" between their top employees. .

Many companies now recognize that high technology, productivity and low earnings cannot be combined and sustained over a long period of time. As such many employers are seeking to sustain their competitiveness through pay increases which are more related to performance measures as a way of absorbing increased labour costs, while at the same time rewarding and motivating employees (Aggarwal and Samwick, 1998).

Mohamed (2004) surveyed performance measures for executive compensation schemes in public listed companies in Kenya while Gitau (2002) studied compensation of professional employees. Other studies in Kenya have investigated the link between corporate performance and management compensation (Ogoye, 2002). Apart from Kilika (1999) who studied managers' compensation preferences and the existing compensation schemes in co-operative bank of Kenya and Muthigani (2005) who studied the administration of employee compensation schemes among commercial banks in Kenya, there is a gap in research on performance based pay .This research therefore seeks to fill the gap by focusing on the use of performance based pay in commercial banks in Kenya.

1.4 Objectives of the study

The objectives of this study were:

i. To establish the extent of use of performance based pay by Commercial Banks in Kenya.

ii. To determine the factors that influence the extent of use of performance based pay by Commercial Banks in Kenya.

1.5 Importance of the study

This study is important because of the following reasons:

i. Researchers and other scholars can use the findings of this study to debate on the area of performance-based pay and carry out more research on the same.

ii. The government will find the results of this study important for their policy recommendations in the area of labour market in commercial banking sector.

iii. The commercial banks will also find the results useful as a basis for their choice of this system as a compensation scheme.

CHAPTER TWO: LITERATURE REVIEW

2.1 Compensation

Morale and job satisfaction are affected by compensation (Aggarwal and Samwick, 1998). Often there is a balance (equity) that must be reached between the monetary value the employer is willing to pay and the sentiments of worth felt by the employee. In an attempt to save money, employers may opt to freeze salaries or salary levels at the expense of satisfaction and morale (Demsetz, 1995). Conversely, an employer wishing to reduce employee turnover may seek to increase salaries and salary levels. Compensation may also be used as a reward for exceptional job performance (Aggarwal and Samwick, 1998). Examples of such plans include bonuses, commissions, stock, profit sharing, and gain sharing.

Compensation will be perceived by employees as fair if based on systematic components. Various compensation systems have developed to determine the value of positions. These systems utilize many similar components including job descriptions, salary ranges/structures, and written procedures. The components of a compensation system include job descriptions job analysis, job evaluation, salary surveys and policies and regulations (Garen, 1994).

Pay determination may have one or more objectives, which may often be in conflict with each other. The objectives can be classified under four broad headings (Milgrom and Roberts, 1992; Murphy, 1998b; and^ Stebler et al, 1997). The first is equity, which may take several forms. They include income distribution through narrowing of inequalities, increasing the wages of the lowest paid employees, protecting real wages (purchasing power), the concept of equal pay for work of equal value. Even pay differentials based on differences in skills or contribution are all related to the concept of equity. A second objective is efficiency, which is often closely related to equity because the two concepts are not antithetic. Efficiency objectives are reflected in attempts to link a part of wages to productivity or profit, group or individual performance, acquisition and application of skills and so on. Arrangements to achieve efficiency may be seen also as being equitable (if they fairly reward performance) or inequitable (if the reward is viewed as unfair). A third objective is macro-economic stability through high employment levels and low inflation, for instance. An inordinately high minimum wage would have an adverse impact on levels of employment, though at what level this consequence would occur is a matter of much debate. Though pay and pay policies are only one of the factors which impinge on macro-economic stability, they do contribute to (or impede) balanced and sustainable economic development. The fourth objective is the efficient allocation of labour in the labour market. This implies that employees would move to wherever they receive a net gain; such movement may be from one geographical location to another or from one job to another (within or outside an enterprise). Such movement is caused by the provision or availability of financial incentives. For example, workers may move from a labour surplus or low wage area to a high wage area. They may acquire new skills to benefit from the higher wages paid for skills. When an employer's wages are below market rates employee turnover increases. When it is above market rates the employer attracts job applicants. When employees move from declining to growing industries, an efficient allocation of labour due to structural changes takes place.

2.2 Performance Based Pay

There is a wide variety of methods used, but all schemes assume that the promise of increased pay will provide an incentive to greater performance.

There are various reasons that have been advanced for use of performance based pay system in organisations. Performance based pay is used (Holmstrom, 1992): to clarify objectives and engage employees with the organization's goals; to motivate employees by linking pay to achievement of targets not length of service; to reward achievement and identify under performance; foster teamwork and fairness; to contribute to overall improvements in productivity; to introduce more flexible pay systems or deal with recruitment and retention problems; and in the case of some employers, to give greater power to managers and weaken trade union influence in bargaining and representation of staff.

There are many different forms of performance related pay, which may be used on their own or side by side. The types of schemes that fall within the description of performance pay are varied. Broadly speaking, they consist of schemes designed to share or distribute the financial results of enterprise performance with or to employees (Holmstrom, 1992). In essence, performance pay is based on paying the worker for his or her value, rather than the value of the job.

Such schemes fall into four broad categories (Aggarwal and Samwick, 1998): individual-based or based on individual performance, such as incentive schemes and sales commissions; profit-sharing, which applies to all or most of the employees; gain-sharing measured by a pre-determined performance formula, applicable to all or groups of employees; and employee share ownership schemes. Employers may move from one to another. The key to all performance pay systems is the measurement required to determine the output on which to base payments. The main steps are: setting objectives;

appraisal results; and linking achievements to pay (and deciding where the money comes from).

2.2.1 Factors influencing use of performance based pay

There are various reasons that have been advanced for use of performance based pay system in organisations. PBP is used (Holmstrom, 1992): to clarify objectives and engage employees with the organization's goals; to motivate employees by linking pay to achievement of targets not length of service; to reward achievement and identify under-performance; foster teamwork and fairness; to contribute to overall improvements in productivity; to introduce more flexible pay systems or deal with recruitment and retention problems; and in the case of some employers, to give greater power to managers and weaken trade union influence in bargaining and representation of staff

The effectiveness of any pay system depends on many factors. However, there are some problems inherent in all performance related pay schemes. A wide range of research has found schemes less effective than expected. In the public sector this is frequently due to cash limits making rewards for high performance ratings too small to motivate staff. Problems of poor training for managers and inadequate communication with staff have had a negative impact on staff morale. Studies show that performance-related pay does not contribute to improve performance but do cause jealousies between staff and undermine moral (Dowling and Richardson, 1997, Marsden and French, 1998).

Because performance related pay systems are based on appraisal of the individual worker, often by their line manager, bias and personal favoritism can influence the result of pay reviews. Instead of motivating workers, performance pay can "undermine performance of both the individual and the organisation by undermining team work, encouraging a short term focus and leading people to believe that pay is not related to performance, but to having the 'right' relationships and an ingratiating personality" (Schaefer, 1998).

Recent research found that performance based pay systems often discriminate against women because: the appraisal process is subject to gender bias and stereotypes; women's skills are often undervalued by their managers (and by women themselves); women—especially those working part time ~ have fewer opportunities for training, and managers are less likely to correctly assess women's training needs (Murphy, 1998). Performance pay may run counter to the development of objective, gender-neutral job evaluation schemes, which are being introduced to achieve equal pay for work of equal value. A study by the Institute of Personnel and Development, found that almost two-thirds of employers had no provision for monitoring sex and racial discrimination in their performance related pay systems.

Whether extrinsic rewards such as performance-related pay actually motivate employees to better performance is a matter of controversy. It has been claimed that monetary rewards usually have a limited time-span in regard to their motivating effect (Milgrom and Roberts, 1992). Therefore extrinsic rewards such as performance pay, even if they can exert a continuing impact on performance, should be consistent with overall management objectives, so that performance pay may not be consistent with, for example, a purely cost reduction strategy; only be used to reinforce a motivational system in which intrinsic (non monetary) rewards exist, such as reorganization of work processes, training, employee involvement/consultation in decision-making, two-way communication, opportunities to contribute ideas, career development plans and goal setting.

Morgan (1998) summarized the reasons for the failure of performance-based pay. He argues that some of the problems and issues facing employers flow from a variety of circumstances such as inadequate criteria to measure performance, or criteria, which are not easily understood, communicated and accepted. Performance pay should therefore be negotiated. Another reason is that PBP is an inappropriate performance appraisal system in that the objectives of the appraisal system (e.g. where it is intended to identify training needs or suitability for promotion) do not match the objectives of the reward system. The absence of regular feedback on performance is also a critical issue related to PBP. The reward system is not designed to meet the objectives sought to be achieved. There could be a variety of objectives e.g. to satisfy distributive justice, attract and retain capable staff, match particular levels of pay in the labour market, change organizational culture (e.g. towards greater customer satisfaction) or to reinforce it.

Morgan(1998) further argues that the absence of a right mix of extrinsic and intrinsic rewards has also been advanced as one of its problems. PBP also lacks an appropriate quantum of pay, which should be subject to performance criteria. This occurs when the amount, which depends on performance, is too sma\\, or it is too large and therefore the amount placed at risk (when performance is poor) is not acceptable to employees. PBP also suffers from the absence of periodic evaluation of the scheme. Non-recognition of the fact that performance, especially profit, is sometimes (even often) dependent on factors outside the control of employees e.g. management decisions, exchange rates, recessions is a problems that has been associated with the performance based pay system.

2.3 Performance Based Pay and Employee Performance

The development of performance based pay schemes has generally been viewed as a response by employers to the principal-agent problem inherent in the employment relationship. Many workers have a wide range of discretion in how they undertake their work. They can vary their effort, their cooperation with colleagues and management, and their contribution to improving the effectiveness of both their and related inputs. In such a situation, mechanisms are needed to ensure that workers (the agents) undertake their work in a manner that is congruent with the interests of their employers (the principals) (Zingales, 2000).

The principal-agent problem can be most directly addressed by the close monitoring of workers' performance and the disciplining of workers deemed to be shirking. However, this can prove costly, not only because of the need to pay supervisors, but also because the demonstration by employers of a lack of trust in their workers can encourage behaviour based on narrow opportunistic motives (Milgrom and Robert, 1992). An alternative is to design incentive schemes to reward individual or group output (Jensen, 1990). Such schemes have the advantage to the firm in that they not only induce greater effort from workers, but they may also encourage the commitment of workers and reinforce existing cultures and values where these foster high levels of performance, innovation and team-work.

Linking pay to performance also potentially introduces equity and consistency in the pay structure and enables the firm to attract more able workers (Morgan, 1998). Incentive systems based on individual performance are, however, problematic for a number of reasons. First, it may be difficult to disentangle each individual's contribution to production. This is seen to be particularly important for jobs involving specific human capital (Hall and Liebman, 1998). Secondly, the output of a work team might exceed the sum of individual contributions. Thirdly, such schemes are seen to discourage what

Hermalin and Wallace (1996) term 'political interaction' among workers, which often positively influences the level of output. Moreover, compensation systems that tie pay to individual performance can be divisive and conflict with other employment strategies based on team-working and inclusive forms of employee involvement (Lazear and Rosen, 1981). Finally, individual performance related schemes are costly to monitor, may be applied in an arbitrary and inconsistent manner and can promote unhealthy competition between workers, which reduces output levels.

It has also been suggested that performance related pay schemes based on individual measures of performance could be particularly problematic where the attaining/sustaining of competitive advantage requires that the work process undergoes continual change. This can be expected where either consumer demands are subject to constant and significant change and where innovation is the key to product market success. Performance related pay schemes based on individual performance (especially piece-rates) can increase the resistance of workers to changes in work or product lines, because their productivity is likely to be lower in new rather than familiar settings (Zingales, 2000). Recent changes in technology making customization possible and permitting a wider range of firms to attain cost-competitiveness without recourse to expensive technology have increased the range of firms to which this potentially applies, thereby reducing the scope for successful individual-based performance related pay.

Performance-related incentive systems based on group output are potential responses to the problems associated with individual performance systems. These are more likely to promote and value employees working co/Zaborative/y to *achieve goals arid objectives* that involve teamwork and co-operation. However, they suffer from a fundamental freerider problem. The failure of the individual to contribute fully to group effort has little impact on that individual's earnings if other members do not shirk (Conyon and Schwalbach, 1997). The rational instrumental worker will therefore minimise his/her own effort, while encouraging the other workers to maximize theirs.

It has been suggested that the principal-agent problem is often best mitigated via the development of an environment based on 'high trust' relationships. Demsetz (1995), for example, suggests that managers need to try and develop clan-type organisations. Employee participation schemes and group-based performance related pay can be seen as part of an attempt by employers to encourage such relationships (Crawford et al., 1995). Offering workers increased involvement in decision-making, a financial involvement in the performance of the organisation and linking pay to performance goals and achievements are all seen as ways of encouraging loyalty, motivation and commitment. Central to this argument is the role of peer pressure. Lazear and Rosen (1981) distinguish between internal and external pressures. Internal pressure is basically the guilt that someone feels if they do not perform well even though their own contribution is not observed. It does not therefore involve direct pressure from peers. Internal pressures arise from feelings of loyalty to colleagues and from the development of team-spirit at the workplace. External pressures arise from the shame associated with not performing well and exist in situations where there is mutual monitoring and each individual's contribution is observed by colleagues. The notion of "norms" can be used to explain the operation of peer pressure in such situations and, in particular, how workers whose level of effort or output deviates from the group norm will be ostracized by colleagues.

In a similar vein, Hall and Brian (1998) demonstrate how the optimal incentive scheme in organisations that have a long-life span is one that promotes cooperative behaviour amongst workers through team-working and peer-monitoring. Group incentive schemes provide both the motivation and means to exert peer sanctioning, whilst team-based production creates mutual dependence amongst workers and thus the possibility of peer sanctioning.

It can therefore be expected that individual performance related pay schemes are likely to be successful in improving organizational as well as employee performance in only a narrow range of work settings (Barro and Barro, 1992), namely those in which team-working is not important, where high-trust relationships are not correlated with performance, where it is easy to disentangle individual contributions to output and where the key to competitive success does not lie in constant change to the work process (either because of continually changing consumer demands or the need to be highly innovative) (Hermalin et al, 1998). That is not to say that such schemes can never be successful; there are likely to be some jobs for which these conditions are met, at least to some degree. Moreover, it is not certain that group-based performance related pay schemes will be successful in situations where they are not met. Unless organisations are able both to prevent free riding and to tie their schemes to other aspects of the production process, they are unlikely to yield performance benefits (Milgrom and Roberts, 1992).

The increased development of work systems offering workers a greater role in decision making and in increasing functional flexibility in recent years has focused enhanced attention on the need to develop innovative pay systems (Holmstrom, 1992). Innovations such as quality circles, briefing groups, total quality management and team-working have resulted in a marked change in the way in which work is done. They involve workers taking more responsibility for key aspects of the production process and, in particular, being more responsive to product market pressures (Holmstrom, 1992). Such changes not only empower workers in key areas, but also intensify the potential for principal-agent divergences. There is evidence that workplace changes aimed at increasing employee participation in decision-making are typically only successful in raising organizational performance where they are associated with compatible gain-sharing mechanisms (Garen, 1994). This suggests that it is important to analyse the interactions between performance related pay schemes and those innovations which are aimed at increasing worker decision-making responsibility. Such initiatives are typically part of an attempt by firms to develop some form of team-working and are therefore likely to be more compatible with group forms of performance related pay rather than the more divisive individual forms. The fourth hypothesis to be tested is therefore that group-based performance related pay will have more positive interactions with employee involvement schemes (vis-a-vis productivity) than individual performance related pay schemes

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Research Design

This was a descriptive survey design. It is the best design for this study because it gives a more representative analysis as well as a wider scope about the banks preferences of the performance based pay.

3.2 Population of study

The population comprised of all the 44 commercial banks in Kenya (Central Bank, 2007).

3.3 Data collection

The data was collected using a structured questionnaire. The questionnaire was divided into three parts named A, B and C. Part A comprised of questions seeking general information about the respondents. Part B of the questionnaire sought the extent of use of performance based pay in commercial banks while part C comprised questions on the factors that influenced performance based pay in commercial banks. The respondents were the Human Resource Managers or their equivalent in the commercial banks. The questionnaire were administered through drop and pick method.

3.4 Data analysis

The questionnaires were checked for correct completion and consistency. Data was analyzed using tables and percentages. Comparisons were made between the different types of schemes used by different banks and the reasons there of. Frequency distribution was used to summaries the factors that determine the use of performance based pay by the banks.

CHAPTER FOUR: DATA ANALYSIS AND FINDINGS

4.1 Introduction

This chapter contains the research findings and discussions of the findings. It analyzes the extent of use of performance based pay in banks.

4.2 Response rate

Forty out of a total number of 44 questionnaires were completed and returned. This represented a 90% response rate.

4.3 Number of branches

Table 4.1 Number of Branches

Branches	Number of banks
4-10	14
Over 10	26
Total	40

Table 4.1 shows that 14 banks have between four to ten branches while 26 banks had more than 10 branches. The small banks were concentrated in Nairobi town with a few branches in other towns. The big banks were found to have more than 10 branches that are scattered all over the major towns. This indicated that the majority of banks had a network of branches that are controlled from their head offices in Nairobi.

4.4 Demographic Data

Table 4.2 Number of employees in the banks

No of employees	Number of banks
30-60	2
60-100	5
100-150	8
Over 150	25
Total	40

The findings of the study from table 4.2 indicates that 25 banks have over 150 employees. This is due to their branch network that requires more people to run their operations.8 banks said they had between 100 and 150 employees and this were found to be the medium banks with branches in major towns only. Five banks indicated they had between 60-100 employees and were majorly operating in Nairobi with a few branches in Mombasa and Kisumu only. Only two banks had between 30 to 60 employees and were only found in Nairobi with one to two branches in the outskirts of Nairobi only.

The study discovered that the reason why majority of banks have fewer workers is because of the cost of maintaining the employees .Banks always aim at minimizing their operation costs; they would rather overwork a single employee than employ an extra one.

4.5 Duration that banks have used these schemes

Table 4.3 Duration of use

Duration of use	Number of Banks
Since incorporation	11
Just started	2
After reorganization	21
After major loses were incurred	6
Total	40

A majority of banks (21) were found to have started using the performance based pay after reorganizations in their structures and operations. Over the years competition has become cut throat and the banks had to reorganize their departments and cut down on their wage bills by declaring redundancy. This forced them to consider introduction of performance based pay to retain the remaining staff and to increase productivity.il banks had been using the schemes since incorporation whereas 6 had started using the schemes after they incurred major losses due to increased operating costs cased by shrinking market of retail customers to the small banks. Only 2 banks had just started using performance based pay to increase productivity and motivate its workforce. Due to increased competition and the entry of new banks many banks found it necessary to reorganize their operations into cost centers and this called for adoption of performance based pay for some cost centers so as to improve profitability.

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4.4 Use of Performance Based Pay

All the commercial banks use performance based pay system to compensate their employees. Whereas some of the multinational banks have standards set from their head offices abroad on the variety of performance based pay to be used for different categories of employees, the indigenous bank have the options of deciding which schemes favor their operations.

Table 4.3 pay system used by the bank

Performance based pay schemes	Number of banks
Piecework	7
Merit pay	8
Profit related pay	6
Organization wide incentives	9
Payment by result	8
Competence based pay	2
Total	40

The findings indicate that seven banks use piece work for data entry jobs in which individuals entering cheque amounts have virtually no interaction with co workers; workers control the rate of data entry and the computer tallies the rate of production. Under production incentive, workers who surpass minimum production are given a bonus payment based on costs savings associated with higher savings. So as to attain competitive advantage, banks have introduced a royalty incentive which is awarded to those who have invented a successful product like mobile banking.

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Merit pay which is used by 8 banks calls for distribution of pay based on an appraisal of a workers performance. It is usually folded into the base pay of the recipient and is usually granted as a percentage of a workers base pay. These banks prefer this scheme due to the

Profit related pay which was used by 6 banks is a group incentive plan which is designed to motivate cost savings by allowing workers to share in the benefits of increased profits. These schemes are not related to an individual's performance, but are linked to the profits of an enterprise, a part of which is paid as a bonus to the workers. It may be a cash payment, or a deferred payment kept, for instance, in a special fund for a particular period. These schemes are not related to an individual's performance, but are linked to the profits of an enterprise, a part of which is paid as a bonus to the workers. The banks use numerous types of schemes including gain sharing.

Organization wide schemes which are used by 9 banks are designed to share the companies prosperity with its employees and thus to increase their commitment to its objectives and values. This includes Gain sharing, profit sharing and share ownership plans. In profit sharing the banks use either a pre determined percentage of profit which is allocated to a pool. The pool is disbursed to employees on the basis of some ratio, usually related to the employees wages.

Only 2 banks use competence based pay .Their employees receive financial rewards in the shape of increases to their base pay by reference to the level of competence they demonstrate in carrying out their roles. It is a method of paying people for the ability to perform now and in the future. Skill-based pay refers to a pay system in which pay increases are linked to the number or depth of skills an employee acquires and applies and it is a means of developing broader and deeper skills among the workforce. Such increases are in addition to, and not in lieu of, general pay increases employees may receive. The pay increases are usually tied to three types of skills: horizontal skills, which involve a broadening of skills in terms of the range of tasks, vertical skills, which involve acquiring skills of a higher level depth skills, which involve a high level of skills in specialised areas relating to the same job.

Table 4.5 Categories of staff and performance based pay system

Categories of Employees	Pay system	Number of banks
All employees	Organization wide schemes	6
CEO only	Competence based pay	3
Top and middle level managers only	Payment by results	21
Sales staff only	Commission and bonuses	10
Total		40

The above table shows the findings on employees paid using the performance pay system.

From the findings, it was clear that top and middle level managers only are the ones that were paid using payment by results as indicated by 21 banks. All the managers in the banks have targets that have to be achieved by their teams and must produce results. 10 banks said sales staff only were paid by use of sales incentive plans which includes commissions and bonuses. Commission plans pay sales people for results only and it's a payment of a percentage of the sales^ results. Commission schemes typically treat the sales person as a self-standing profit unit. Banks use bonuses for surpassing sales targets. An absolute figure could be used or a fixed amount as per policies of the bank. The banks

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have sales force that has set targets and are paid a retainer and commissions for every new account opened and loans advanced.

6 banks reported all employees are paid using organization wide schemes. They include profit sharing plans and stock options where all employees receive a share of the banks annual profits. The banks have given their employees the opportunity to own shares at a discount as others have put in place loan facilities for employees willing to invest in shares. The remaining 3 banks said they pay Chief Executive Officer only using competency based pay. The banks pay for the Chief Executive Officer range, depth and type of skills and knowledge rather than the job title they hold. The Chief Executive Officer are the driving forces behind the banks performance.

Table 4.5 Criteria used by banks in determining the performance based pay schemes to use

Criteria	Number of banks
Bank achieving some target	20
Personal targets achieved	5
Departmental targets achieved	11
Others	4
Total	40

According to the findings in the above table on the criteria that the banks use in awarding \Yvese schemes, banks sa\& vV\a\ deXeravme \Yvese. schemes w'\\en achieve some targets which included profit levels and increased customer base. 11 banks said that the criteria is determined when departmental targets are *met, while 5* banks said schemes are determined when personal targets are achieved. Personal targets include achieving targets in terms of units and exceeding customer expectations. The remaining 4 banks said that they considered other factors like a human resource management strategy which uses pay to reinforce larger business strategies and whether the overall climate in the

bank is favourable to performance and productivity. For instance, banks which encourage employee involvement policies and practices have experienced better results with performance pay.

4.5 Factors Influencing Use of Performance Based Pay System

Motivation to all-This was found to be a major factor influencing the use of performance based pay by the banks. The individual performance based pay schemes motivate individuals as they are paid according to their own performance. Those who contribute more are paid more. For the team based schemes the whole team benefits from its concerted efforts and hence will work harder to earn more. Expectancy theory explains why more pay leads to higher performance .Motivation is a function of the perception a worker has about the likelihood that more effort will lead to valued outcomes like more money.

Fairness to all-Most respondents strongly agreed that performance pay schemes are fair to all as each individual is paid according to their output. The banks use different performance measures both quantitative and qualitative to set targets for individual employees which are used to determine tho performance based pay schemes.

Mix of intrinsic and extrinsic rewards-The banks use a mix of intrinsic and extrinsic rewards to balance for their pay system to be effective. Performance based pay should be consistent with overall management objectives, so that performance pay may not be consistent with, for example, a purely cost reduction strategy; only to be used to reinforce a motivational system in which intrinsic (non-monetary) rewards exist, such as the reorganization of work processes, training, employee involvement/consultation in decision making, two way communication, opportunities to contribute ideas, career development plans and goal setting.

Performance measures-The banks identify measures of performance for their employees like outputs, behaviours and cost reductions that are related to the banks strategic plans. The banks tie pay only to those aspects of value that are critical for their operations. The banks are now using the 360 degree method to appraise their employees whereby questionnaires with leadership, management, communication, vision, expertise, drive and adaptability are developed and administered.

Quantum of pay-The banks reported that the amount that can be lost due to poor performance is carefully determined by analyzing performance measures that are related to the controllable costs, so as to exclude what is beyond the control of employees. These schemes are su7fficiently flexible to absorb downturns and adequately reward when performance is good.

Discrimination-The banks reported that performance based pay is discriminatory and it ultimately involves distinguishing workers on the basis of their performance. There is a large behavioral literature arguing that treating employees differently from each other is detrimental to employee morale. The notion is that a worker will feel badly if a co-worker gets bigger bonus, and the net effect of this inequity may affect productivity. However the banks found it more economical to pay using performance based pay.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses and summarizes the findings of the study as they relate to objectives of the study. It also includes the limitations of the study as well as the suggestions for further research.

5.2 Summary

The objectives of the study were to find out the extent of use of performance based pay in commercial banks and the factors that determine the use of these pay systems. The respondents consisted of 40 employees from commercial banks in Kenya. The response rate was good at 90% of the targeted respondents.

The researcher intended to obtain response on the extent of use of performance-based pay in commercial banks in Kenya. It was found out that the majority of banks as indicated by 26 banks had over 10 branches in Kenya, and the majority of these banks also had over 150 employees who were spread in various parts of the country.

The study also revealed that all these banks use performance based pay system to a certain extent, and the kind of pay system that the banks used were found to be organization wide incentives (9), payment by result (8), piecework (8), profit related pay (6).The banks move from one system to another while some use more than one system to cater for different employee categories.

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It was also clear that in the majority of these banks (21), top and middle level managers only are the ones who are paid using payment by results, and all sales staff is paid by commissions and bonuses. The findings showed that the criteria that the majority of banks use in awarding these schemes were in the basis of the firm achieving some targets as indicated by 20 banks. The study also revealed that the majority of banks have used the performance-based schemes after reorganization as was indicated by 21 banks.

The banks indicated that the factors they consider in choosing performance based pay include motivation to all, fairness, and mix of intrinsic and extrinsic rewards and quantum of pay. However all the banks agreed that discrimination in pay leads to better performance.

5.3 Conclusions

From the findings in chapter four and the discussions in this chapter, the conclusions arrived are that commercial banks in Kenya use performance based pay system to compensate employees and in majority of these banks the top and middle level managers are the ones compensated using this system.

The factors that influence the extent of use of performance based pay by commercial banks in Kenya were to motivate staff, fairness to all, appropriate appraisal system ,mix of intrinsic and extrinsic rewards.

5.4 Recommendations

From the discussions and the conclusions in this chapter, the researcher recommended that performance based pay system should be used on a\\ employees as motivate staff, it is fair to all, and it is also an appropriate appraisal system to all employees.

For employees to achieve their personal targets they should also be compensated, as this will also lead to the bank achieving its targets. For instance, with the use of stock options, the employees would feel that they own part of the banks. As a result they would work harder towards organizational improvement since they identify with that organization. Performance based pay is a very important aspect of strategic human resource reward policies. If well advocated it can act as a tool for not only motivating employees but also improving their morale in order to achieve high productivity.

5.5 Limitations of the Study

The main limitation in this research was that commercial banks are very busy organizations where most of the respondents were busy throughout, had to continuously be reminded, and even persuaded to provide the required information.

Due to the nature of the study the managers were reluctant to divulge certain company details about performance based pay in individual banks due to confidentiality. This information is considered by the banks as a competitive tool.

5.6 Suggestions for Further Research

A similar study can be conducted in a different kind of industry to find out whether other firms apart from banks use performance-based pay and the extent of use. The respondents should also be broadened to cover not only middle and top management but also all the employees in organization.

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APPENDICES

Appendix 1: Introductory Letter

University of Nairobi
School of Business
Department of Business Administration
P.O. BOX 30197
NAIROBI

To
Human Resource Managers
Commercial Banks
Nairobi

Dear Sir/Madam,

RE: COLLECTION OF DATA

I am a postgraduate student at the University of Nairobi, School of Business. In order to fulfill the degree requirements, I am undertaking a management project on **"extent of use of performance based pay in commercial banks in Nairobi."**

You have been selected to form part of this study. This is to kindly request you to assist me collect the data by filling out the accompanying questionnaire. I will collect it from your premises. The information data you provide will be used exclusively for academic purposes. My supervisor and I assure you that the information you give will be treated with utmost confidence.

Your cooperation will be highly appreciated.
Thank you in advance.

Yours faithfully

Nzioka Joyce	**George Omondi**
Student	**Lecturer/Supervisor**

Appendix 2: Questionnaire

Part A: General Information

1. Name of bank:
2. Respondent's designation:
3. How many branches does the bank have? Tick appropriately

Below 4 [ ]

4-10 [ ]

Over 10 [ ]

4. How many employees does the firm have?

Below 30 [ ]

30-60 [ ]

60- 100 [ ]

100 - 150 [ ]

Over 150 [ ]

Part B; Extent of Use of Performance Based Pay

1. Does your bank use performance based pay system? Tick appropriately.

Yes [ ] No [ ]

2. What kind of pay system does your bank use? You can tick more than one choice

Piecework [ ]

Merit pay [ ]

Profit related pay [ ]

Organization wide incentives [ ]

Payment by result [ ]

Competence based pay [ ]

Others(specify)

3.Who does the firm pay using the system(s) above?

All employees [ ]

CEO only [ ]

Top and middle level managers only [ ]

Sales staff only [ ]

Others (specify) ——......—

4. What other factors does your bank consider in compensating apart from performance?

Experience [ ]

Seniority [ ]

Education background [ ]

Others(specify)

5. What criteria does the bank use in awarding these schemes?

Firm achieving some target [ ]

Personal targets achieved [ ]

Departmental targets [ ]

Others (specify)

6. For how long has your bank used these schemes?

Since incorporation [ ]

Just started [ ]

After reorganization [ ]

After major losses were incurred [ ]

Part C: Factors Influencing Use of Performance Based Pay System

State you level of agreement as outlined in the table below: the pay system;

	Strongly agree	Agree	Indifferent	Disagree	Strongly disagree
Motivates staff					
Is fair to all					
It discriminates					
Lacks tools to measure performance					
Is appropriate appraisal system					
Has no regular feedback on performance					
Mix of intrinsic and extrinsic reward is poor					
Lacks appropriate quantum of pay					
Does not recognize factors beyond control of employee					

Appendix 3: List of Commercial Banks in Kenya

1. African Banking Corporation
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank of Kenya
6. CFC Bank
7. Charterhouse bank
8. Chase bank
9. Citibank
10. City Finance bank
11. Co-operative bank of Kenya
12. Commercial Bank of Africa
13. Consolidated bank
14. Daima bank (Statutory)
15. Development bank of Kenya
16. Diamond Trust bank
17. Dubai bank
18. EABS bank
19. Euro Bank
20. Equatorial Commercial bank
21. Equity bank
22. Family bank
23. Fidelity Commercial

24. Fina bank

25. Giro commercial bank

26. Guardian bank

27. Habib A.G.Zurich

28. Habib bank

29. Imperial Bank

30. Investment and Mortgages bank

31. K-Rep bank

32. Kenya Commercial bank

33. Kenya Post Office Savings Bank

34. Middle East bank

35. National bank of Kenya

36. National Industrial Credit bank

37. Oriental Commercial bank

38. Paramount Universal bank

39. Prime Bank

40. Southern Credit bank

41. Stanbic bank

42. Standard Chartered bank

43. Trans-National bank

44. Victoria Commercial bank